

General Information Letter: Correct computation of foreign tax credit explained.

September 2, 2003

Dear:

This letter is in response to the questions you raised in your telephone conversation with Joyce Sowerby of the Director's Office. The nature of your inquiry requires that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.revenue.state.il.us.

My review of your 2002 Illinois income tax return and the correspondence in our file shows that, on your Schedule CR, you claimed a credit of \$12,496 for taxes paid to California, New York, Missouri, Arizona and Kansas. We reduced that credit to \$7,373, as the result of recomputing the amount of income tax was double taxed by Illinois and by California, New York and Missouri, respectively. For the reasons discussed below, the correct credit is \$9,346. We will be sending you a refund of the overpayment resulting from increasing the amount of credit allowed.

For California, you reported double-taxed income of \$87,943. I have not been able to determine how this amount was computed. Computing double-taxed income following the instructions on the Publication 111, we computed double-taxed income of \$39,337. This is 7.54% (the percentage of your income from California sources, as computed on your California return) times the sum of all items of income included in taxable income by both California and Illinois, net of all deductions allowed by both California and Illinois. See 86 Ill. Admin. Code Section 100.2197(b)(4)(G). In this case, the Publication 111 instructions contain an error. They direct taxpayers to compute double-taxed income by starting with federal adjusted gross income, and then subtracting retirement income (which is not taxed by Illinois, and is subtracted on Line 5 of the Form IL-1040) and also subtracting the deduction allowed by California for Social Security benefits on Line 20 of the California Schedule CA. Because Social Security benefits are included in the subtraction on Line 5 of the Form IL-1040, Publication 111 erroneously requires these benefits to be subtracted twice. When this error is corrected, your income taxed by both Illinois and California is \$41,458.

The instructions in the Publication 111 for computing income double-taxed by New York contain a similar error. On your Schedule CR, you reported \$99,843 in income double-taxed by New York. Again, I have not been able to determine how this computation was made. In accordance with the instructions in the Publication 111, we reduced that amount to \$73,767. This is 14.21% (the percentage of your income from New York sources, as reported on your New York return), times the sum of all items of income included in taxable income by both New York and Illinois, net of all deductions allowed by both New York and Illinois. However, the those instructions contain an error with respect to the \$8,946 in state income tax refunds that are included in federal adjusted gross income and subtracted on Line 7 of the Form IL-1040 and on Line 23 of the New York Form IT-203. The Publication 111 instructions erroneously require these refunds to be subtracted twice in computing double-taxed income. When this error is corrected, your income taxed by both Illinois and California is \$75,037.

Lastly, on your Schedule CR, you reported \$189,132 in income double-taxed by Missouri. This is the sum of Missouri-sourced incomes reported by each of you on the Missouri Form MO-NRI. According

to 86 Ill. Admin. Code Section 100.2197 and the Publication 111 instructions, however, your double-taxed income is the percentage of income from Missouri sources times the sum of all items of income included in taxable income by both Missouri and Illinois, net of all deductions allowed by both Missouri and Illinois. This computation must be done separately for each spouse, and the two amounts added together, because that is how Missouri computes taxable income on a joint return. Following the instructions in the Publication 111, we determined your income double-taxed by Missouri was \$91,159. Again, the Publication 111 has an error that affected this computation. It directs taxpayers to subtract state income tax refunds twice in this computation – once for the \$8,946 deduction claimed on Line 7 of Missouri Schedule MO-A and once for the \$8,946 subtraction taken on Line 7 of Form IL-1040. In addition, we subtracted this same \$8,946 amount from both spouses' incomes, when this subtraction can obviously be taken only from one spouse. Finally, we subtracted the \$139,106 in retirement income and Social Security benefits shown on Line 5 of your Form IL-1040 from both spouses' incomes, rather than from just the spouse who earned that income. When these errors are corrected, Missouri double-taxed income is \$154,276.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy General Counsel – Income Tax